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**BY FAX AND BY POST**
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The Hon. Margaret Ng, Chairman
Bills Committee on Companies
(Corporate Rescue) Bill,
Legislative Council Secretariat,
3rd Floor, Citibank Tower,
3 Garden Road, Central,
Hong Kong.

Dear Ms. Ng,

**Companies (Corporate Rescue) Bill**

The Hong Kong Society of Accountants has reviewed the Companies (Corporate Rescue) Bill and would like draw the matters referred to below to the attention of the Bills Committee.

Principal Issues

*Payment of employee entitlements*

While we understand that there has been opposition to providing for the entitlements of workers dismissed in a corporate rescue through the Protection of Wages on Insolvency Fund or other channels, as opposed to the trust fund arrangement, we believe that the provisions in the Bill requiring all liabilities owed to employees, including contingent liabilities, to be provided for by means of a trust fund, if not in cash, will create a substantial obstacle to the success of the procedure.

In practice, particularly in view of the personal liabilities imposed on the provisional supervisor ("PS") under the Bill, the trust fund is likely to have to contain all entitlements under the Employment Ordinance for all employees. This is so because the PS may not know at the initial stage how many employees he would wish to retain and the Bill stipulates that the fund must be sufficient to cover the entitlements of all "former" employees" including those that the PS intends to dismiss in the course of the provisional supervision ("PSN").

It needs to be pointed out that, unlike Protection of Wages on Insolvency Fund and the preferential payments in a liquidation under the Companies Ordinance, the Bill as drafted places no limits on the employee entitlements that must be provided for in respect of e.g. severance payments. This would mean for example that a highly-paid employee who is on one year's notice would have to be paid a year's salary in lieu of notice.

One of the implications of this is that where a proposed PSN collapses due to insufficient support from creditors, or for other reasons, and the company proceeds into liquidation, employees will be in a much better position than they would have been had the company gone into liquidation straight away, while all other unsecured creditors, on the other hand, will be worse off, as the monies contained in the trust fund will have been ring-fenced and will be payable to the employees, in effect, as a statutory preference. The proposed framework therefore will create for employees a very strong vested interest in seeing a company undergoing the early stages of a PSN before being wound up, even if they are aware that the future prospects of the company are not good and that ultimately it is likely to go into liquidation. Under such circumstances, a conflict may well arise between the PS who is endeavouring to preserve the existence of the company or any part of it that may be viable and employees who, if they are not confident about the future of the company, would rather take all their entitlements and look for work elsewhere. While the PS has a duty to make every effort to find a workable rescue proposal, he may find himself dealing with employees who are uncooperative because they may benefit more immediately by seeing the PSN fail. This, together with the personal liabilities of the PS, will tend to undermine the basis of co-operation between the PS and employees and adversely affect the independence and impartiality of the PS.

The situation envisaged above will be exacerbated by the fact that, while the issue of voting by "connected persons" has been addressed the new Bill, there are no provisions that would subordinate the claims of directors, or their family members or associates, who are employees of the company, to other creditors. In addition therefore to the general problems that we envisage with the trust fund proposals, this would make the arrangements open to abuse by unscrupulous directors.

These potential problems will not be lost on major creditors and will no doubt be a significant factor to be borne in mind when they consider the option of PSN. The main providers of corporate funding, namely the banks, are unlikely to be willing to provide additional financing for a corporate rescue if, for example, they believe that this will be used primarily to discharge liabilities owed to employees by the company.

As a result of these concerns, the proposed corporate rescue procedure can be expected to be of assistance only to a very small number of companies that have few employees and/or are cash rich. We would also stress that practitioners are aware of no comparable corporate rescue procedure overseas that provide guaranteed benefits for employees in this way.

*Personal liabilities of PS*

As suggested, we believe that the imposition of personal liabilities on the PS in respect of the entitlements of employees who are retained by him will affect the ability of the PS to act independently, impartially and in the best interests of all parties. Given the uncertainties that this creates it is likely that a prospective PS will be unwilling to take up the office unless the trust fund contains the contingent liabilities of all employees, or unless there are few long-serving employees employed by the company. He will also be encouraged to terminate all employees at the outset and possibly re-hire those vital to the continued operation of the company in PSN.

The uncertainty on the part of the PS will be increased by the fact that it is unclear how he would be able to discharge his liabilities in situations where, for example, the creditors ultimately decide that they would prefer to put the company into liquidation and they want to appoint a liquidator other than the individual who is the PS or where a voluntary arrangement proceeds but then subsequently fails. Indeed, even if the voluntary arrangement proceeds as agreed it is not clear to what extent the PS can transfer personal liabilities to, say, the supervisor of the voluntary arrangement. Even if he were able to do so, which is questionable, then the same uncertainty would apply to the supervisor, who has assumed those liabilities.

Under the provisions of the Bill, the PS is entitled to an indemnity from the assets of the company. The continuing liability to which he may be subject could necessitate his retaining control over certain assets until he is sure that the liability has been discharged or transferred. This may affect the success of the PSN or voluntary arrangement or the dividend available to the creditors generally in the event of the company being wound up.

*Secured creditors*

We support the change to the definition of "major (secured) creditor", such that creditor is not required to have a claim under a charge amounting to at least $33^{1}/_{3}$% of the liabilities of the company immediately before the relevant date in order to be so regarded. However, it would appear that the holder of, for example, a third or fourth charge over the company's property, who in practice, would be unlikely to be able to enforce his security owing to the insufficiency of the company's assets would nevertheless fall within the revised definition of "major secured creditor" and would therefore still be able to stand in the way of a proposal for a voluntary arrangement. It is not clear how the situation would be resolved if the holder of a first or second charge meanwhile agreed to the proposal. Applications to court are likely to be costly and should be avoided where possible. One of the aims of the procedure seems to be to minimise court intervention, but there is a danger that in practice, the lack of specific provisions for alternative means of resolving conflicts or uncertainties will result in the need for the involvement of the court more frequently than envisaged. If so, this will also be potential impediment to the success of the procedures.

*Separate ordinance*

While we have no strong view in principle as to whether the corporate rescue procedure is introduced via provisions in the Companies Ordinance ("CO") or as a separate ordinance, we believe that in the latter case any new ordinance needs to be self-contained. We have some doubt whether simply applying the interpretation section of the CO to this Bill will be adequate to ensure the new ordinance will stand alone. Under the Bill, for example, the PS has a duty to investigate the affairs of the company and, as soon as practicable, to take into custody or under control all the property to which the company is or appears to be entitled (Schedule 4, Part 1, ss. 1-2). Yet it seems that the PS does not have the specific powers available to liquidators under the CO to call for an examination of persons who may have relevant information or to require the delivery up of company property.

Furthermore, we query whether the various substantial provisions dealing with insolvent trading, contained in Schedule 8 of the Bill, should properly be regarded as consequential amendments to the Companies Ordinance arising from the other provisions of this Bill.

*Insolvent trading*

We are concerned that part (b) of the definition of "responsible person" in the proposed new section 295A of the CO is too broad. Part (a) of the definition already includes directors and shadow directors and s2 of the CO defines "director" as including "any person occupying the position of director by whatever name called". We believe that the equivalent provisions in UK on which these are based do not extend to a level below director. We have been given to understand that, when the Law Reform Commission made the recommendation to include certain non-director-level staff, it had in mind persons who for example are in effective control of the Hong Kong operations of an overseas company but who are not formally appointed as directors of the company. If this is so, and the definition of “director” under s2 of the CO does not clearly cover such persons, then the definition of “responsible person” should be limited so as to target them more specifically.

Although under the provisions of the proposed s295C(2), a manager can discharge his responsibility by issuing a notice in a specified form to the Board of Directors, we would not regard this as an adequate “escape route” to justify a potential declaration of a liability for insolvent trading against middle management staff. Firstly, the prospect of issuing such a notice could put the manager concerned in an invidious position because he may fear that this will cost him his job. Secondly it is doubtful whether the potential liability should be extended in this way, in any case, given that a responsible person may be held liable in circumstances where he did not in fact suspect that the company was engaging in insolvent trading. Under the provisions of s295C(1)(c)((ii)(B), a court needs to be satisfied only that there were reasonable grounds for suspecting that there was no reasonable prospect that the company could avoid becoming insolvent, in order to make such a declaration, i.e. it appears to be an objective test.

There is a general concern arising from several UK cases, that a liquidator may not be able to recover the costs of legal action in relation to insolvent trading out of the assets of the company. Certain UK cases have held that preference and wrongful trading actions arise solely as a result of the liquidation of the company and therefore, strictly speaking, the potential recoveries do not represent the assets of the company. Although, under the proposed s295E(2), compensation payments that a person declared liable for insolvent trading may be ordered to make may include the costs incurred by the liquidator in seeking the declaration, there remains a doubt about the ability of the liquidator to recover costs if, for example, the action is unsuccessful or there is an out of court settlement. This uncertainty is likely to result in a reluctance on the part of liquidators to initiate such actions unless they are open and shut cases. We would suggest therefore that it be put beyond doubt in the legislation that a liquidator can recover his costs for such actions out of the assets of the company.

--- In addition to the key areas of concern outlined above, the Society has a number of detailed points on the Bill. These are contained in the attachment to this letter. Many of them have previously been raised in the context of our submissions on the Companies (Amendment) Bill 2000 but as they appear not to have been addressed in the current Bill we have taken the opportunity of repeating them.

Yours sincerely,

PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS & PRACTICE)
HONG KONG SOCIETY OF ACCOUNTANTS

PMT/ay
Encl.

**Attachment**

Detailed Comments on the Companies (Corporate Rescue) Bill

A. Corporate Rescue Provisions

*Clause 3*

It is suggested that provision be made for the Financial Secretary to be able to apply the law to regulated institutions in particular cases. This could provide greater flexibility to deal with the rescue of a financial institution. It is understood, for example, that the sale of Barings Bank in the UK was conducted in the context of an administrative arrangement.

*Clause 4*

It is not clear what is intended to happen in the case of a person who is temporarily suspended from practising as a professional accountant or a solicitor. It would provide for greater flexibility if it were to be stipulated that revocation of a person's membership on the Panel could be permanent or for such period as the Official Receiver ("OR") specifies.

*Clause 5*

We do not support the proposal to require security to be posted. No such requirement is specified in relation to schemes of arrangement under s166 of the Companies Ordinance ("CO") or to creditors' voluntary windings-up. This will add to the cost of the procedure, diminish its convenience (which will add further to costs and result in unnecessary additional administration by the OR's Office) and is contrary to the trend in other jurisdictions to move away from bonding. We are also aware of difficulties that some practitioners have found in obtaining bonds if they do not have a previous history with the bond suppliers, particularly given that the market for such products in Hong Kong is very limited. It is also unclear how any such security would be determined given the wide variety of companies that in principle could enter into PSN.

*Clause 7*

There is now less of an imbalance in the Bill between the extensive legal framework for PSN and the more limited provisions for the implementation and termination of a voluntary arrangement, as clause 7(3) of the Bill provides specifically for a number of matters to be included in the terms of the voluntary arrangement. However, it should be made clear that these matters are not necessarily exhaustive. We understand that in Australia a proforma deed of company arrangement is specified. Consideration should be given to introducing a similar procedure here (see also our comments in relation to clause 31 below).

*Clause 8*

In order to alleviate the potential problems with the arrangements for the trust fund explained under "Principal Issues" above, consideration should be given to capping the trust fund in individual cases to either the ceiling of payments under the Protection of Wages on Insolvency Fund or to the CO, s265 limits.

*Clause 9 and Schedule 1*

Under the Bill, the requirements for issuing notices are less extensive than those in the Companies (Amendment) Bill 2000 ("C(A)B"), such that, except in the case of the initial notice of appointment of the PS and advertisement for claims from creditors, the PS is only required to publish other notices in the Gazette. We would suggest that the PS should in addition be required to write to all creditors whose details can be ascertained from the company's books and records. In any event this is good practice.

*Clause 10 and Schedule 4*

We have raised concerns above about the PS' liabilities in the "Principal Issues" section above. Clarification is needed as regards when and how a PS's liabilities will end. Can the PS later disclaim contracts that he has adopted or adopt them conditionally at the outset? If not, what happens if, for example, the creditors do not agree that the company should be wound up where this is the PS's recommendation?

Consideration should be given to providing for the imposition of sanctions on persons to whom the PS has delegated authority who knowingly act outside the scope of their delegated powers and contrary to the interests of the company.

*Schedule 4, Part 4*

It is not clear why it needs to be specified that the PS will not be entitled to an indemnity in respect of contracts, remuneration and fees, etc. attributable to misconduct or negligence, and the inclusion of such a statement could invite disputes. It is already stated that the indemnity relates to <u>reasonable</u> fees, etc. Presumably it would be hard to argue that misconduct and negligence should be included within the scope of what is regarded as reasonable.

*Schedule 4, Part 5*

We believe that provision should be made for the creditors to approve variations in fees from the OR's scale, subject to appeal to a remuneration panel (along the lines proposed by the Law Reform Commission (see Chapter 4 of the "Report on the Winding-up Provisions of the Companies Ordinance", July 1999)). The court would then not need to get involved unless there was a further appeal in respect of the decision of the panel on a point of law.

There is an imbalance in the Bill in that the court must be satisfied that an increase of fees is warranted based the factors listed in section 3, but is not required to take into account any specific factors in dealing with an application for reducing fees under section 4. Before considering any reduction in fees the court should be required to take into account the actual work done by the PS.

*Clause 11*

We would suggest that the moratorium also extend to the commencement of any actions in respect of directors' liabilities under a personal guarantee. We understand that such actions are included under the equivalent procedure in Australia. This would give directors a greater incentive to consider PSN.

Clause 11(6) terminates the appointment of a (provisional) liquidator upon the appointment of a PS. However, under the circumstances described in clause 19(2)(b) (major secured creditor rejects the idea of PSN) or clause 22(6) (meeting of creditors rejects the proposal), then clause 11(6) is deemed never to have terminated the appointment of the (provisional) liquidator. This provision is presumably intended to be purely procedural. However, as drafted, it may give rise to some uncertainty over whether, for example, the (provisional) liquidator could argue that certain dispositions made by the PS were void or voidable (see s182 of the CO). While it is quite possible that the PS and the (provisional) liquidator would be the same person, it will not necessarily be so.

*Clause 12*

How will creditors be notified of the cessation of the moratorium under clause 12)(2)(c) and what other procedures, if any, will then apply? The end of the moratorium would seem to mean that the directors will resume control over the company. Is it their responsibility to notify creditors of the position? Provisions need to be added into the Bill to clarify this.

*Clause 13*

Clause 13(4) could be confusing if it is intended that it may be invoked at the time that a moratorium is first proposed to be imposed, and it would seem from the wording that this is so, as clause 13 generally relates to an extension of the moratorium. This provision may therefore be better placed in clause 11.

"Significant financial hardship" should not be the sole ground for being exempted from the moratorium. Where the court is satisfied that a secured creditor's collateral is being seriously jeopardized, it should also be able to order exemption.

There is no requirement in this section for the PS to notify creditors of an application to extend the moratorium. A link ought to be made between clauses 13 and 21.

*Clause 14*

The PS as well as the company and the director are bound by actions carried out by a director in contravention of clause 14(1)(a) provided that a third party who deals with the director acts in good faith and changes his position to his detriment. The implications of this for the PS's liability are unclear. It would not be reasonable if the PS were ultimately held to be personally liable for the conduct of a director who was not acting under any delegated authority.

It is not clear why the sanction, previously contained in s168ZI(2) of the C(A)B, against directors acting in contravention of the provision in clause 14(1)(a) of the current Bill has been dropped.

*Clause 16*

As we have suggested above, directors and their family members should not be treated in the same way as other employees, otherwise there will be scope for considerable abuse (c.f. "associates" under s266 of the bankruptcy Ordinance (Chapter 6)).

*Clause 18*

As drafted, this provision seems to suggest that if a creditor is willing to advance further operating capital under this section, then he must provide the entire amount of the minimum required operating capital specified by the PS. Presumably, the point is that the total amount advanced by all willing creditors, whether relevant creditors or not, should be not less that the minimum required operating capital, and arguably all lending during the moratorium should benefit from a similar priority.

It is not entirely clear why fixed charges should have priority over relevant funds in the winding-up of the company, but a floating charge should not. It is also not clear why it needs to be specified in subsection (1) that relevant funds should have priority over other debts of creditors (apart from fixed charges) in the voluntary arrangement. The terms of the voluntary arrangement are in principle are matter for the creditors to agree. It is likely that creditors advancing relevant funds would in any case make this a condition of doing so.

*Clause 19*

Under clause 19(3), where a major secured creditor fails to give the PS the "2nd notice" within 3 working days of his receiving the "1st notice", or 7 days after the relevant date, whichever is the earlier, he is deemed to be bound by the moratorium and other provisions of the Bill. The 7-day period could be too short a time. If there is a long holiday shortly after the relevant date, it is conceivable that a major creditor who did not support the PSN would be compelled to give the 2nd notice before he has even received the 1st notice from the PS notifying him of the appointment of the PS. It would be preferable to express all deadlines in terms of working days.

Under clause 19(2), where a major secured creditor does not agree with the PS proceeding to prepare a proposal, the moratorium will cease and under clause 19(2)(d) the PS is to vacate his office as soon as practicable. However, it is likely that a winding-up petition will be presented and a provisional liquidator appointed shortly afterwards. It is not clear who will be responsible for what if both the PS and a provisional liquidator (assuming it is not the same person) are in office at the same time. The PS may still have outstanding liabilities to settle and there is also the issue of the relative priorities of the costs of the winding up, fees of the liquidator, etc. and the PS's indemnity under Schedule 4, Part 4 to consider. There needs to be a more distinct division between the end of PSN procedures and the commencement of any subsequent procedures and a more clearly-defined procedure for vacating the office of PS.

If the PS has issued the notices under clause 9 at this juncture, and technically he may not have done so, then he should also be required to notify any creditors to whom he has previously written of the cessation of the moratorium. Generally, the time-frames are so tight that there is a reasonable likelihood of these various procedural steps crossing over one another, e.g. the PS could be gazetting his appointment and calling for creditors to lodge their claims (under clause 9) almost at the same time as he is gazetting the cessation of the moratorium. This could lead to confusion amongst creditors.

Other than subsection (4) there are no provisions in the Bill on voidable preferences. This could create problems. A company's directors may have engaged in transactions at an undervalue or given preferences to associated companies, etc. If the PS is unable to take action to recover the assets involved PSN may appear to be a less advantageous option to the general body of creditors.

Consideration should be given as to whether there is a need for provisions in the Bill on valuing unliquidated claims.

*Clause 20*

The acceptable grounds for a PS resigning, as set out in clause 20(4), are too limited and the procedures too inflexible, particularly when judged against the background of the PS's personal liability for contracts that he may have adopted or entered into. Other reasons for a PS wishing to resign would include potential conflicts of interest arising, ill health, etc.

This provision also leaves several questions unanswered. What are the respective personal liabilities of the PS and the former PS? Does the former PS remain liable for contracts that he entered into even where the PS may have acted negligently leading to the company's assets being insufficient to cover the former PS's indemnities? What are the respective priorities of the indemnities given to the former PS and the PS? Presumably, the former PS should have a higher priority for liabilities disclosed at the time of the hand over, but this is not provided for in the section. Is the former PS able to retain control over some of the company's assets to enable him to satisfy his liabilities?

Consideration should be given as to whether the creditors should have a general right to reject the PS within a certain period without having to establish cause, to ensure that creditors view the PS as an independent appointment. Ultimately, if the creditors have no confidence in the PS, they can reject the proposal, but this is a roundabout route, particularly if they believe that there is scope for a proposal to work. We suggest therefore that within a short period of time of his appointment the PS should be required to convene a meeting of creditors to either affirm his appointment or replace him. The meeting could also, if it so determined, form a committee of creditors.

*Clause 21*

The PS should be required to hold the first meeting of creditors within a specified time. Under the Bill, he could defer a meeting until nearly the end of the 6-month period.

As noted above, there are no general provisions on voidable dispositions in PSN. There is only a specific provision rendering invalid any charges created on the undertaking or property of the company within the 12-month period before the relevant date, unless it was proved that the company was solvent immediately after the creation of the charge (clause 19(4)). The PS, however, will have to comment on voidable dispositions to enable the creditors to be able to determine whether a liquidation is more or less advantageous than a voluntary arrangement. Generally, the PS should be required to report on potential claims which may increase the assets available for distribution. Consideration should be given to specifically requiring the PS to provide a liquidation analysis taking into account the assets of the company and the likelihood of recoveries.

Should separate meetings for different classes of creditors be held to prevent oppression by a dominant group? Currently, under Schedule 7 s2, it is stipulated that relevant creditors at a relevant meeting will form one class only.

Under clause 21(2), the PS is only required to make available his report on the company upon request. Under Schedule 6, Part 2 s1(e)(iii)(C), where a proposal for a voluntary arrangement is to be made, the PS is required to make available a summary of the proposal. These provisions may be reasonable in view of the potential size of the relevant documents. However, under subsection Schedule 6, Part 2 s1(f)(ii), where the PS is unable to complete the proposal within the 6-month moratorium period, and under Schedule 6, Part 2 s1(g)(i), where the PS is satisfied that none of the relevant purposes of a voluntary arrangement can be achieved, he is only required to make his statement available upon request. It would seem reasonable if a PS cannot complete a proposal within 6 months or he does not think that a proposal can achieve any of the specified purposes, that he should inform all the creditors of his reasons for this. The relevant statement would presumably not be that voluminous. This is all the more so, as under Schedule 6, Part 2 s1(e)(iii), where the PS is able to complete the proposal within 6 months, he is required to attach a statement to all creditors as to which of the relevant purposes of a proposal can be achieved and which cannot.

*Clause 22 and Schedule 7*

The effect of clause 22(4)(a) is unclear. It appears to require more than 50% in value of creditors present to vote for a resolution before it can be passed. However, the decisions of the meeting to wind the company up and appoint a liquidator are already mandated under clause 22(4)(b) and provision is made under Schedule 7, s7 for the necessary resolutions to be deemed to have been passed where there is no quorum or where the meeting fails to pass the resolutions. The requirement in clause 22(4)(a) therefore appears to be overridden elsewhere.

Creditor’s committees have been an integral part of the administration of insolvency cases. It should be made clear that the creditors can resolve to set up a creditors' committee to act on their behalf. At present the only reference to this possibility seems to be under the powers of the PS in Schedule 4.

The issue of related-party creditors needs to be looked at, particularly given that the Bill proposes that all creditors should form one class for voting purposes. A group of creditors with sufficient voting power and acting together, who may be related to each other, could ride roughshod over the interests of all other creditors. Specific measures have been introduced in other jurisdictions to deal with this problem.

It is suggested that under Schedule 7, s18, it may not be necessary to exclude s265 when backdating the commencement of the creditors’ voluntary winding up to the relevant date. Instead provision could be made for the PS to obtain the sanction of the court for payments properly made under the PSN scheme.

*Schedule 7 and Clause 23*

It is noted that there is no provision for approval of a proposal by shareholders and under the new Bill (as opposed to under the C(A)B)). Shareholders are not permitted to attend a relevant meeting of creditors, even though, under clause 25(1)(b)(iii), a voluntary arrangement is defined a being binding on shareholders, amongst others. There may be situations in which shareholders inject new capital, debt is converted into equity, new classes of shares created (or existing classes cancelled), the company's paid up share capital is altered, amendments need to be made to the company's articles, etc. Shareholders should arguably, therefore, have a greater say in approving a proposal, as with a s166 restructuring, than is provided for by the right to apply to the court if they are aggrieved by a decision made in a relevant meeting of creditors (under clause 23(3). In addition consideration should be given to extending this right to an aggrieved creditor particularly given the lack of any provisions on related-party creditors, referred to above).

It is noted that under subsection (7)(b)(ii), the PS is required to appoint a liquidator, which may be himself, at the latest within 7 days of the meeting referred to in the provision. However, under Schedule 7, s8, where the PS fails to comply with this requirement he is deemed to have appointed himself as the liquidator. This is an odd provision. Prima facie, the PS has breached the provisions of the Bill and should possibly be subject to sanction. If the only purpose of the provision is to ensure that the office of liquidator is filled quickly, then it would appear to be simpler to state under Schedule 7, s7(d)(i) that the PS will be the liquidator unless he appoints another suitable person within a specified timeframe.

Alternatively if it is felt that there is an increased possibility of conflicts arising where the PS becomes the liquidator, then it could be specified that he will assume the office of liquidator only if he has tried in good faith to appoint someone else but has been unable to do so. If on the other hand he has not acted in good faith, then sanctions should be provided for. Another possibility would be to require the approval of creditors before the PS could become the liquidator. We understand that this is the requirement in Australia.

Our comments on the commencement of a winding up under clause 22 and Schedule 7 (i.e. those relating to s265), would also apply to Schedule 7, s18.

It is not clear why under Schedule 7, s18(b)(ii), the remuneration of the liquidator should necessarily be at the same rate as the PS was remunerated before he vacated his office. It will not automatically be the case that the liquidator will be one and the same person as the PS and the logic of binding an incoming independent liquidator to the rate applied to the PS requires further explanation. If the liquidator was appointed by the creditors under clause 22 and Schedule 7, this provision would not apply to him. Therefore there is an inconsistency here.

It is unclear how broad the court's power under Schedule 7, s21(c) is intended to be. In the context, we would assume that the power to extend the moratorium is e.g. in relation to the possible need to reconvene a creditors' meeting and conduct another vote. It would be helpful to indicate in what general circumstances the court could extend the moratorium under this provision.

If the chairman's decision is reversed or varied under Schedule 7, s21(a), this would mean that in the view of the court his decision was manifestly unreasonable. Under these circumstances, why should costs be the liability of the applicant? Is it the intention of Schedule 7, s22 merely to indicate that while costs can be awarded against the company, they cannot be awarded against the chairman personally?

*Clause 25*

In relation to the subsequent steps after a proposal has been approved by creditors, the reference to "matters incidental thereto" under clause 25(1)(a) is too vague. It should be specified for example that minutes of the meeting should be recorded and signed off within a specified period and thereafter retained for a specified period.

Under subsection (1)(b), the terms of the voluntary arrangement should be binding on all creditors, whether or not they received the notice under clause 21(2)(b) or (3), provided that the PS acted in good faith.

*Clauses 26 and 27*

If the supervisor is a different person from the PS, the former should attend and give consent to supervising the voluntary arrangement at a relevant meeting of creditors where the proposal is passed.

"Domestic premises" under clause 27(3)(b) should be defined so as to be limited to premises being used for domestic purposes.

Under clause 27(3), the supervisor may present a petition to wind up of the company if he considers that the voluntary arrangement is not being adhered to by the company. Meanwhile under clause 26 there is in effect a continuing moratorium on creditors bound by the arrangement. The only avenue for creditors who consider that the voluntary arrangement is not being adhered to is under clause 27(6), which provides for creditors aggrieved by any act or omission of the supervisor to apply to the court. This seems to be insufficient. There ought to also to be a requirement to notify creditors where a supervisor files a petition under this subsection.

The provision on deviations under clause 27(5) appears to be too inflexible. If a deviation of substance, which may be beneficial to creditors, is agreed by the creditors, why should the court not be permitted to sanction it?

*Clause 28*

This provision does not deal with the issue of the respective liabilities of the original supervisor and his successor. In fact, more generally, the issue of a supervisor's liabilities and indemnities is not addressed. This is too important an issue to be omitted.

*Clause 29*

Notification should also be given individually to all known creditors.

*Clause 31*

In order for the new procedures to work, regulations will need to be drafted. These should drafted at an early stage given their importance to implementation of the overall procedure. Consideration should also be given to including specific regulation-making powers to provide for procedures relating to voluntary arrangements.

There is no specific reference to regulations relating to the security to be provided by a PS or supervisor under this clause, although the provisions of the Bill dealing with security cross-refer to clause 31. Generally, we have indicated above our reservations on the issue of security, but as regards the particular details of this clause, we do not think it is advisable to rely on the very general regulation-making powers under subsections (2)(h) and (i) to deal with substantive issues that are clearly already envisaged by the Bill

*Other matters*

The trading of shares whilst a company is in PSN is not conducive to achieving a successful restructuring and therefore we would suggest a statutory suspension of share trading during the procedure.

There should be a provision along the lines of s30E of the Bankruptcy Ordinance, to prevent utility companies from “pulling the plug” on a company in PSN.

B. Insolvent Trading Provisions

*Schedule 8*

*New section 295A*

As indicated above, we are concerned that the definition of “responsible person” includes a manager involved to a substantial or material degree in directing the company’s business. This part of the definition could perhaps be limited to senior management who have de facto control over the business or at least direct decision-making responsibility for the extension of credit to the company.

*New section 295C*

There must be some doubt whether some of the non-director-level persons currently caught by the definition of "responsible person" would be aware, or should be expected to be aware, of the form contained in the proposed Seventeenth Schedule to the CO.

The technical revisions to the definition of "insolvent trading" in the Bill make it difficult to see how, under 295C(2)(a)(ii), a manager could have issued a notice to the Board stating that the company is engaging in insolvent trading "before the insolvent trading occurred".

*New section 295E*

It is open to question whether compensation provisions alone would be a sufficient or meaningful deterrent. Given that the persons who may be held liable for insolvent trading includes management, it could be that the person against whom a declaration is made will have little or no means to pay compensation. In the longer term, consideration could be given to introducing criminal sanctions.

*New section 295G*

Consideration could be given to allowing a liquidator to assign a cause of action for insolvent trading with the sanction of the court.

Hong Kong Society of Accountants
25 September 2001